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COUNTY OF LOS ANGELES
TREASURER AND TAX COLLECTOR

MARK J. SALADINO
TREASURER AND TAX COLLECTOR

October 14, 2008

TO: Supervisor Yvonne B. Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: Mark J. Saladino
Treasurer and Tax Collector

SUBJECT: **IMPACT OF FINANCIAL CRISIS (PART 3)**

As the financial crisis continued this past week, western industrial nations have taken numerous ad hoc steps to stem the global panic. Central banks have cut interest rates, governments have agreed to take equity stakes in troubled banks, and regulators have moved to guarantee billions of dollars of distressed debt. Despite these initiatives, the financial markets remain unusually volatile. Last week, the Dow Jones Industrial Average, London Stock Exchange FTSE Index, and Japanese Nikkei Index each declined by more than 20%, before surging in huge rallies yesterday.

The impact of the economic crisis on the County Treasury continues to be minimal. In order to deal with rapidly changing market conditions, my Department has actively managed both the County's borrowing program and investment portfolio. For example, the recent lack of buyers in the short-term municipal debt market threatened to disrupt the County's ongoing commercial paper program. As discussed in my memorandum of October 9 (attached), I have responded to this situation by arranging for the Treasury Pool to intervene and purchase the County's own commercial paper notes if there is no other purchaser.

Recent Events

On October 3, 2008, the President signed into law an historic $700 billion rescue package that gives the Secretary of the Treasury wide-ranging authority to purchase and insure troubled assets from financial institutions. Viewed as a necessary measure to restore confidence in the banking system, the rescue package has so far done little to ease the worldwide credit contraction. Banks remain hesitant to lend to one another and as noted above, buyers have disappeared from many short-term debt markets.

Beginning with record declines in European equity markets on Monday, October 6, the U.S. financial crisis quickly moved overseas and affected Europe's largest banks. In an unprecedented show of international cooperation, the U.S. Federal Reserve Bank, the European Central Bank, and the Bank of England all lowered short-term interest rates by 0.5% on October 8.

During the week since your Board last met on October 7, pressure on financial institutions in the U.S. has continued to increase as many stalwart firms are struggling for survival. On October 8, the federal government announced that it was increasing its loan to American International Group (AIG) by $38 billion to a total of $123 billion. On October 9, Citigroup withdrew its offer to acquire Wachovia and cleared the way for Wells Fargo to acquire the troubled commercial bank. Finally, on October 10, shares of Morgan Stanley in the U.S. and Royal Bank of Scotland in the U.K. completed a week of declines that saw each firm's stock price fall by more than 60%.

Over the weekend, major European leaders agreed on a coordinated plan that would inject an unspecified amount of public money into troubled banks and temporarily guarantee bank debt in an effort to get credit flowing again. In addition, European countries agreed to relax so-called mark-to-market accounting rules that require banks to account for assets at current market prices.

In the U.S., the Treasury Department announced a new plan to invest up to $250 billion in the nation's banks in a move that, in effect, partially nationalizes the participating financial institutions. This plan would also increase FDIC insurance on deposits in non-interest bearing accounts and certain types of bank debt. While the Treasury still intends to go ahead with its plan to purchase distressed debt securities, the new plan of direct investment in banks will likely be the primary focus of the Administration's efforts.

Investment Exposure to Troubled Financial Institutions

AIG, Wachovia, Morgan Stanley, Royal Bank of Scotland

As of October 9, 2008, the County no longer holds any investments in AIG or any of its affiliates. The County does own $25 million in floating-rate notes issued by Wachovia, which are scheduled to mature on January 15, 2010. This investment is considered to be highly secure due to Wells Fargo's approved acquisition of Wachovia.

With respect to Morgan Stanley, the Treasury Pool owns approximately $160 million of medium-term notes with a weighted average maturity of 287 days. While the downward pressure on Morgan Stanley stock has been severe, a key $9 billion capital infusion by Mitsubishi Bank of Japan was successfully completed on Monday, October 13. Furthermore, should the investment by Mitsubishi Bank prove insufficient to meet Morgan Stanley's capital needs, the U.S. government appears poised to make an investment of its own in order to prevent the firm from failing. As a result, we do not believe that our Morgan Stanley holdings are at risk of default.

The County currently owns $300 million in commercial paper notes issued by Royal Bank of Scotland, which have a final maturity date of November 6, 2008. Following a week of speculation, the British government announced on Monday, October 13 that it is purchasing a majority interest in the bank. By effectively nationalizing Royal Bank of Scotland, the British government will be guaranteeing all loans issued by the bank. The County's investment is therefore considered secure.

Lehman Brothers

As referenced in my memorandum to your Board dated September 30, 2008, the County has one outstanding forward purchase agreement with Lehman Brothers Special Financing Inc., which was executed in conjunction with the 2006 Tobacco Bonds financing. On October 3, 2008, my office was informed that Lehman Brothers Special Financing had filed for bankruptcy over the prior weekend. The impact of this event on the County appears to be minimal given that the County holds more than $30 million of collateral in trust pursuant to the forward purchase agreement.

Based on legal opinions delivered concurrently with the execution of the forward purchase agreement, the securities held as collateral are not considered assets of Lehman Brothers Special Financing and are not affected by the bankruptcy proceedings. The credit quality of the collateral securities has been reviewed by my Department and we do not believe them to be at risk of default. Termination of the forward purchase agreement and a full cash settlement is anticipated to occur on November 28, 2008.

Short-Term Borrowing (Commercial Paper)

The County's only variable rate debt is our tax-exempt commercial paper (TECP) program, which currently has $205 million of short-term notes outstanding. As referenced in my October 9 memorandum to your Board (attached), the TECP Program is secured by letters of credit issued by Westdeutsche Landesbank (WestLB), Bayerische Landesbank (BayernLB) and JPMorgan Chase Bank. Due to the loss of confidence in European banks, including WestLB and BayernLB, investor demand for the County's TECP notes has diminished considerably.

To mitigate the threat of higher borrowing costs for the TECP Program, my Department has established new procedures under which the Treasury Pool can invest directly in the County's TECP notes. This initiative was announced publicly to the financial markets on October 9 and had an immediate stabilizing effect on the TECP Program. The interest rate on our TECP notes that had risen to 9% on October 8 and October 9 fell to 4.35% on Friday, October 10.

While the Treasury Pool has not yet needed to step in and purchase any of the County's TECP notes, the willingness to do so has helped spur investor demand and lower our borrowing costs. The County's authority to purchase its own TECP notes has been validated with outside legal counsel and is supported by Internal Revenue Service Notice 2008-88 (issued October 1, 2008) and California Senate Bill 344 (approved by the Governor on March 26, 2008).

Summary

The current crisis has exposed significant challenges in the world's financial system and brought about a near cessation in normal lending practices. The global credit contraction threatens not only private corporations, but also state and municipal governments throughout the U.S. For the past four months, the County's Treasury Pool has been limited to short-term investments, most with maturities of thirty (30) days or less. This emphasis on liquidity in the Treasury Pool should provide the County with sufficient cash to operate despite the ongoing credit market instability and its impact on State or Federal funding of County and local programs.

My Department has worked diligently to protect the financial interests of the County and to maintain a viable investment and borrowing program. With continued vigilance, we believe the County Treasury will remain well-positioned to withstand the ongoing financial crisis.

Attachment

c: Executive Officer of the Board of Supervisors
Chief Executive Officer

ATTACHMENT

COUNTY OF LOS ANGELES
TREASURER AND TAX COLLECTOR

MARK J. SALADINO
TREASURER AND TAX COLLECTOR

October 9, 2008

TO: Supervisor Yvonne B. Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: Mark J. Saladino
Treasurer and Tax Collector

SUBJECT: **IMPACT OF FINANCIAL CRISIS (PART 2)**

Last week I sent your Board a report concerning the impact of the current financial crisis. This memorandum is to apprise your Board of new developments affecting the two German banks that provide letters of credit (LOCs) that support our tax-exempt commercial paper (CP) program.

Our CP program is secured by letters of credit provided by Westdeutsche Landesbank (WestLB), Bayerische Landesbank (BayernLB) and JP Morgan Bank. Our program is additionally secured by a State guarantee of the Federal Republic of Germany, which backs up the letter of credit issued by WestLB, as agent bank for our three LOC banks, through 2015.

This week several European banks, including WestLB and BayernLB, required capital injections to offset their subprime loan exposure. This has created a loss of investor confidence regarding the long-term viability of many European banks. Coupled with the ongoing market uncertainties, this has resulted in weak investor interest in our CP.

Yesterday there were no buyers for $38.75 million of our maturing CP. Our dealer, Morgan Stanley, bought this CP overnight for their inventory at an interest rate of 9%. Today the $38.75 million plus $64 million of additional maturing CP was re-offered and sold by Morgan Stanley to two investors for one day, but again the rate was 9%.

The credit contraction that started in commercial banks and mortgage lenders has now spread to the debt market for both taxable and tax-exempt issuers. In many cases there is simply no market; fear and uncertainty have resulted in a temporary absence of buyers for short-term instruments. Even the State of California has been unable to issue Revenue Anticipation Notes to finance its short-term cash needs, and the State

Controller recently projected that the State's internal resources will be exhausted on October 29. If external financing does not become available by then, the State may be unable to make disbursements, including payment of amounts due to the County, cities, schools and other agencies within Los Angeles County.

Overall the current market environment is one of crisis, fear and impulsive response to any piece of bad news. In the case of our CP, investors are not distinguishing between banks such as WestLB which is guaranteed by the German government, and banks whose letters of credit are not similarly guaranteed. Moreover, investors are not looking past the banks to the County's high credit ratings which under normal circumstances would further reassure investors. In time we expect a return to rational credit differentiation. However, in the short term our CP program will likely be disrupted not just because of its association with foreign banks but also because of general market conditions.

My office is moving quickly to provide liquidity support to our CP program by arranging for the Treasury Pool to purchase maturing commercial paper whenever there are no other buyers at reasonably competitive rates. This will be similar to the program approved by your Board earlier this year to support the Museum of Art and the Natural History Museum with their auction rate securities. In order to minimize the County's financing costs, we expect to begin purchasing our own CP as early as Friday, October 10, 2008, and will continue to do so until market conditions improve.

We are continuing to monitor the financial system and capital markets very closely, as conditions are evolving quite rapidly. We will promptly advise your Board of any further material developments as they occur.

c: Executive Officer of the Board of Supervisors
Chief Executive Officer

COUNTY OF LOS ANGELES
TREASURER AND TAX COLLECTOR

MARK J. SALADINO
TREASURER AND TAX COLLECTOR

October 30, 2008

TO: Supervisor Yvonne B. Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: Mark J. Saladino
Treasurer and Tax Collector

SUBJECT: **IMPACT OF FINANCIAL CRISIS (PART 4)**

On October 14, I presented your Board with an update on the current financial crisis and its impact on the County Treasury. Among other issues, I described market conditions affecting the County's tax-exempt commercial paper ("TECP") program. This memorandum will discuss recent developments in the short-term debt market and the current status of the TECP borrowing program.

As described in my memorandum dated October 10, 2008, the County's TECP notes are secured by letters of credit issued by two German banks (Westdeutsche Landesbank and Bayerische Landesbank) and by JPMorgan Chase Bank. As a result, the program is highly sensitive to disruptions in the banking sector. Earlier this month, as European banks faced increasing liquidity and solvency challenges, interest rates on the County's TECP notes spiked as high as 9% on October 8 and October 9.

As you know, in order to offset the threat of higher TECP interest costs my office arranged for the County Treasury to purchase the County's maturing TECP notes in the absence of other buyers. As I reported to your Board on October 14, the Treasury's willingness to make such purchases immediately helped to restore confidence in the County's TECP program and enabled us to sell TECP notes at the interest rate of 4.35% on October 10. As of today, it has not been necessary for the Treasury to intervene in the capital markets and purchase any of the County's TECP notes.

Our second step to stabilize the TECP program was to expand the number of broker-dealers that sell the TECP notes to investors. On October 15, my department added JPMorgan as a third broker-dealer to the TECP program (the other two are Barclays Capital and Morgan Stanley). This action fostered a new level of competition among the firms that sell these securities in the capital markets. The impact of this change has been dramatic and has helped to reduce interest rates on the County's TECP notes from 4% on October 15 to just 1.2% on October 29.

Our ability to issue TECP notes at rates as low as 1.2% is only partially due to the efforts of the finance and investment office in my Department. The most important factors in lowering the County's borrowing costs have been recent developments in the financial markets. Governments throughout the industrialized world have taken extraordinary measures to inject capital into the banking system to restore liquidity to the credit markets.

In the U.S., the Treasury Department has begun implementing the $700 billion Emergency Economic Stabilization Act, and each of the nine largest U.S. banks is participating in the recovery program (along with many smaller banks). The Federal Reserve has also been active and initiated a program to purchase $540 billion of distressed securities from money market mutual funds. These actions were followed by the Federal Reserve's decision on October 29 to lower its benchmark federal funds rate to 1%, the lowest level since June 2004.

Because TECP interest rates fell this week to below 2%, it appears that the County's TECP program is moving towards a period of normalcy and stability. While the program has benefited from the coordinated efforts of governments and central banks throughout the world, there is no guarantee that the current stability in the commercial paper market will continue. There is still a considerable amount of uncertainty in the credit markets and buyers are taking a very cautious approach towards their investments.

My department will continue to actively monitor the County's TECP program and take all prudent and necessary steps to protect it from further market turmoil. I will promptly advise your Board of new material developments.

c: Chief Executive Officer
Executive Officer of the Board of Supervisors